

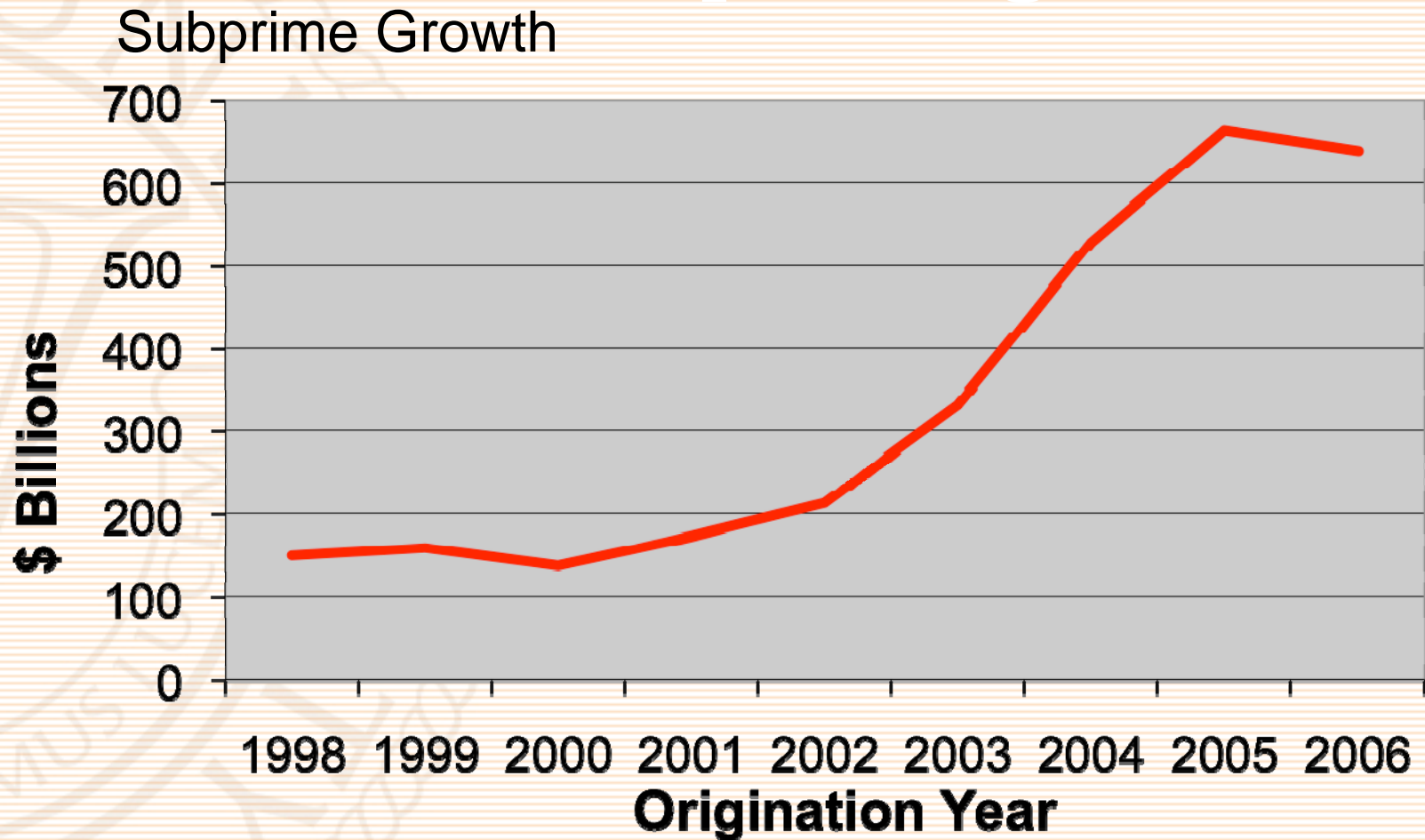
## The Foreclosure Crisis in Indiana and the US



Alan M. White  
April 16, 2008

# VALPARAISO UNIVERSITY SCHOOL OF LAW

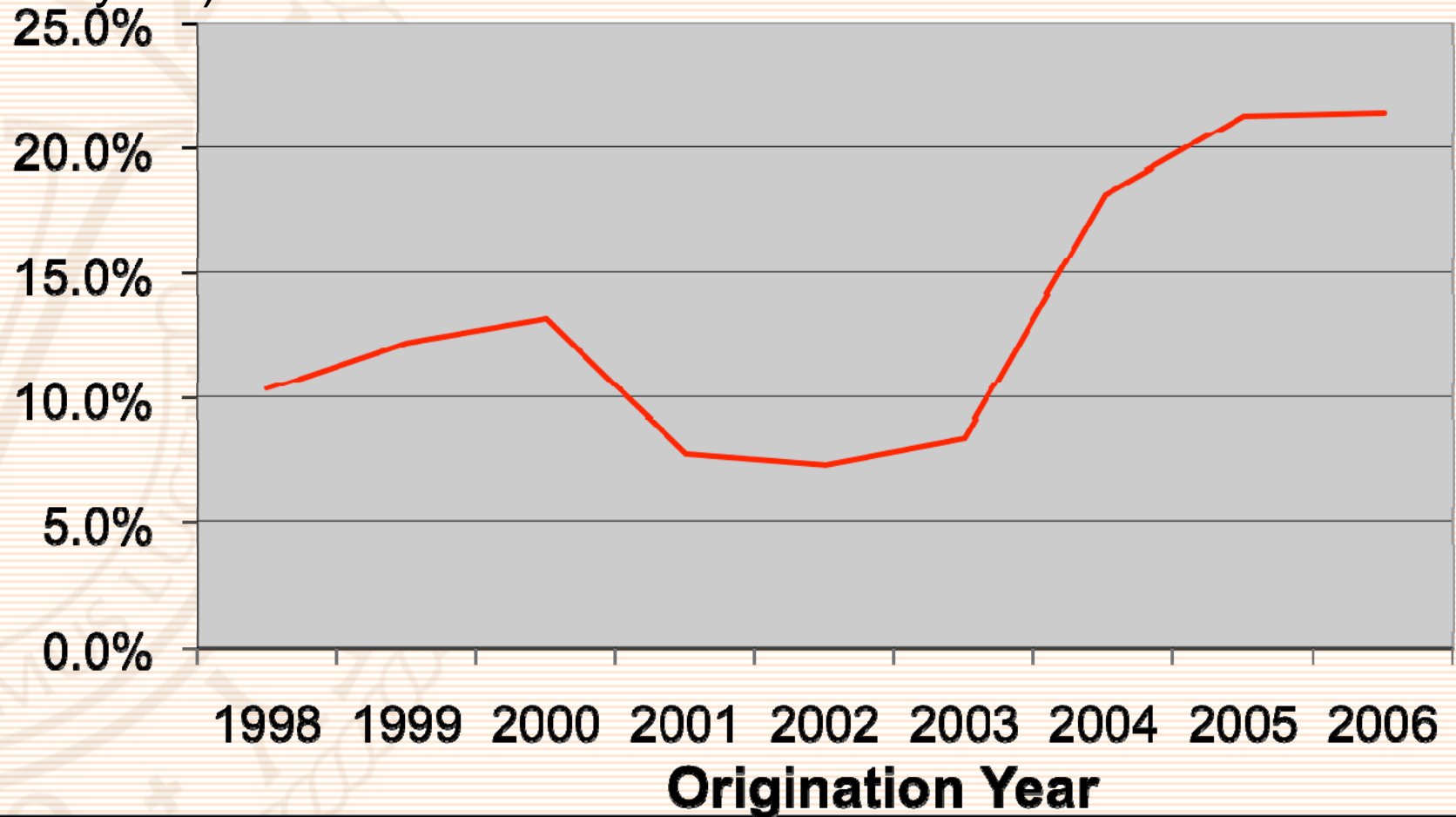
## Subprime growth



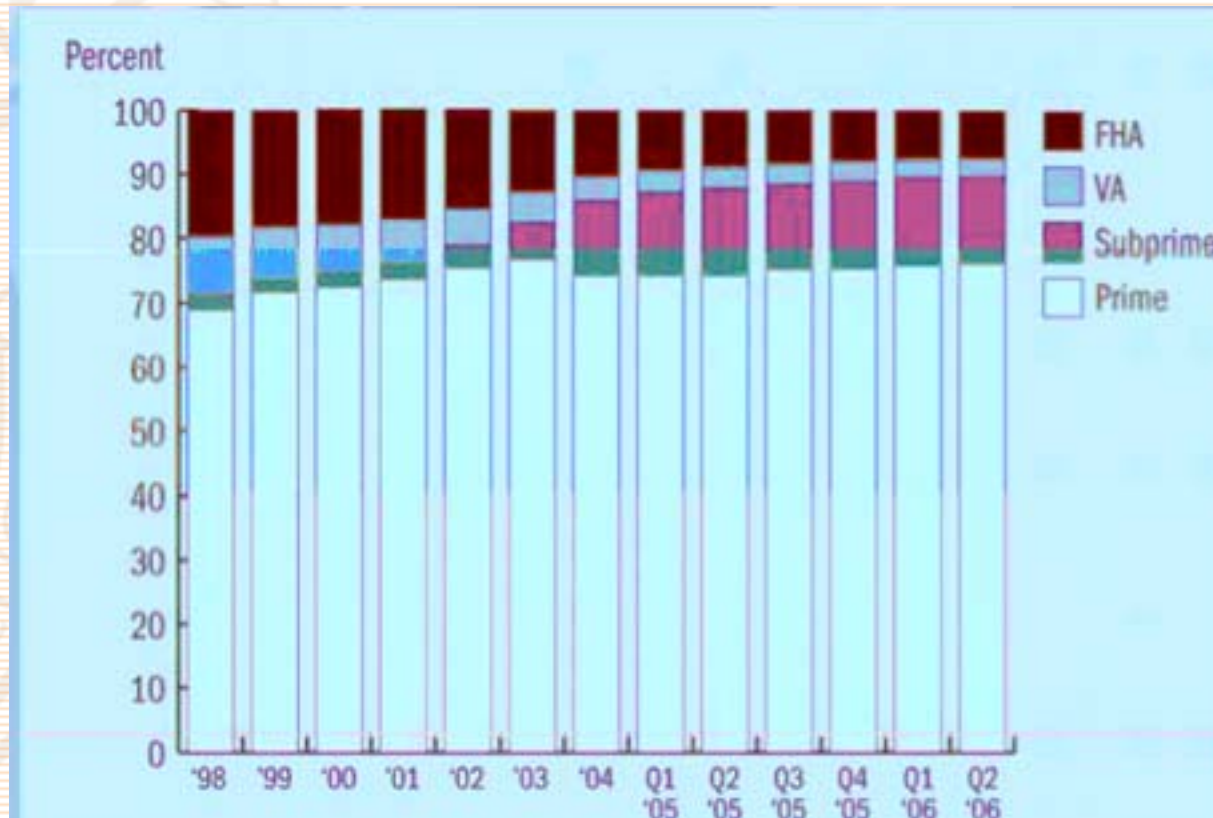
Source: IMF Publications



## Subprime Share of All Mortgages (by origination year)



## Subprime Displaced FHA



## Defaults and Foreclosures

- Subprime ARMs now reaching 30% late pmts (Q3 2007)
- Fitch Ratings predicts 50% of 2006 subprime loans will be foreclosed
- Expected losses > 20% of orig bal
- 225,000 foreclosures/mo in 2007/08
- 3 million a year BEFORE resets

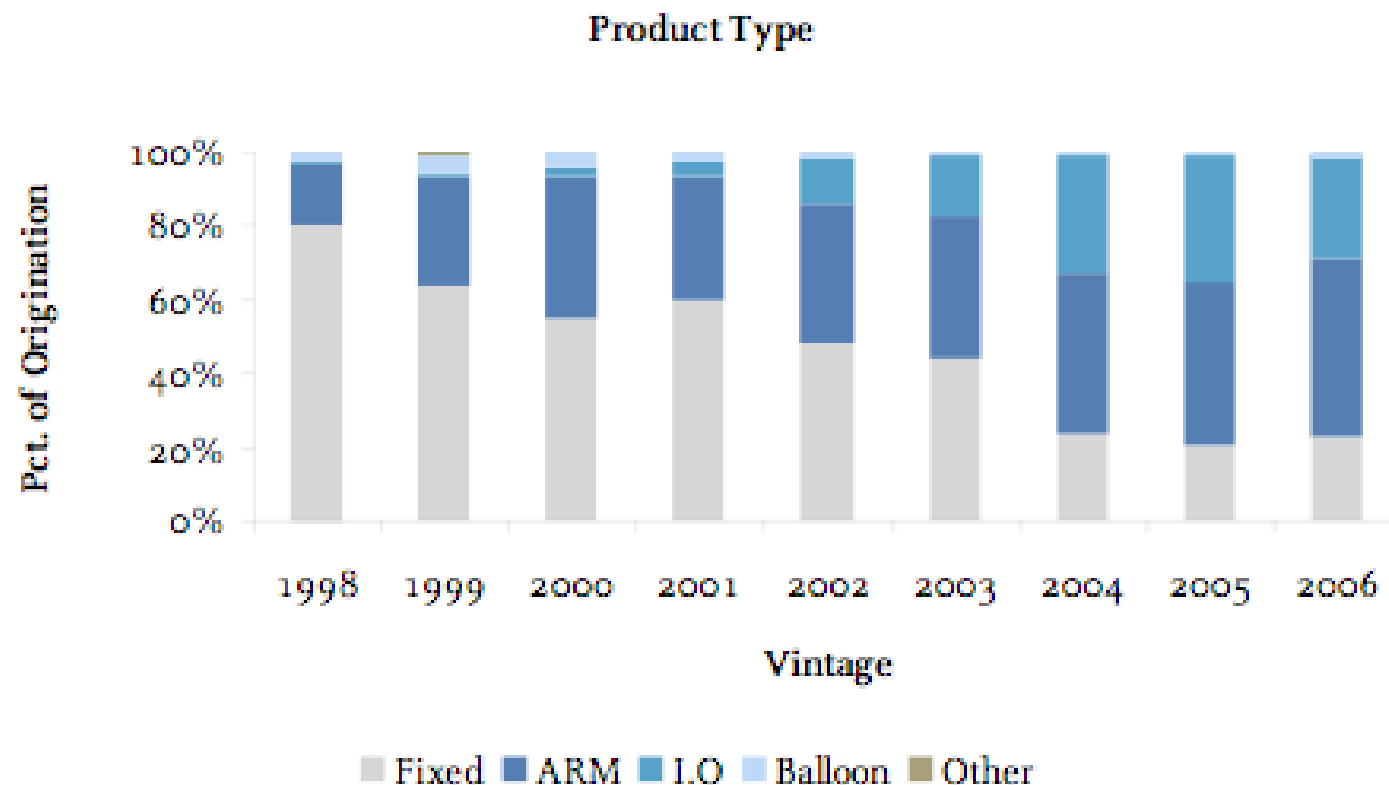


## Causes of Foreclosure crisis

- Bad underwriting, risk layering
- Failure to Escrow, the hidden payment reset at month 12
- Stated income - NINJA loans
- No down payments, piggyback loans
- NOT the 24 month ARM resets, YET





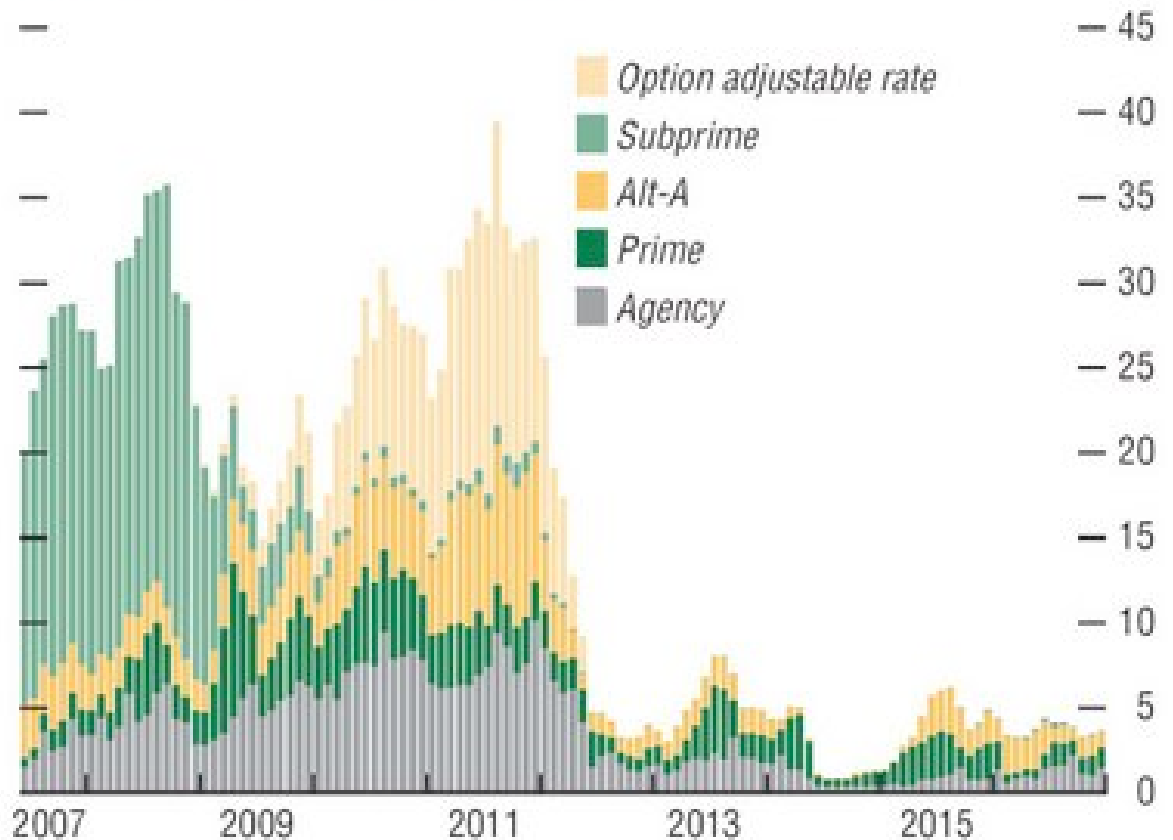


Source: Loan Performance and Wachovia Capital Markets, LLC.



## ARM Resets - Still to Come

**Figure 1.7. Monthly Mortgage Rate Resets**  
(First reset in billions of U.S. dollars)

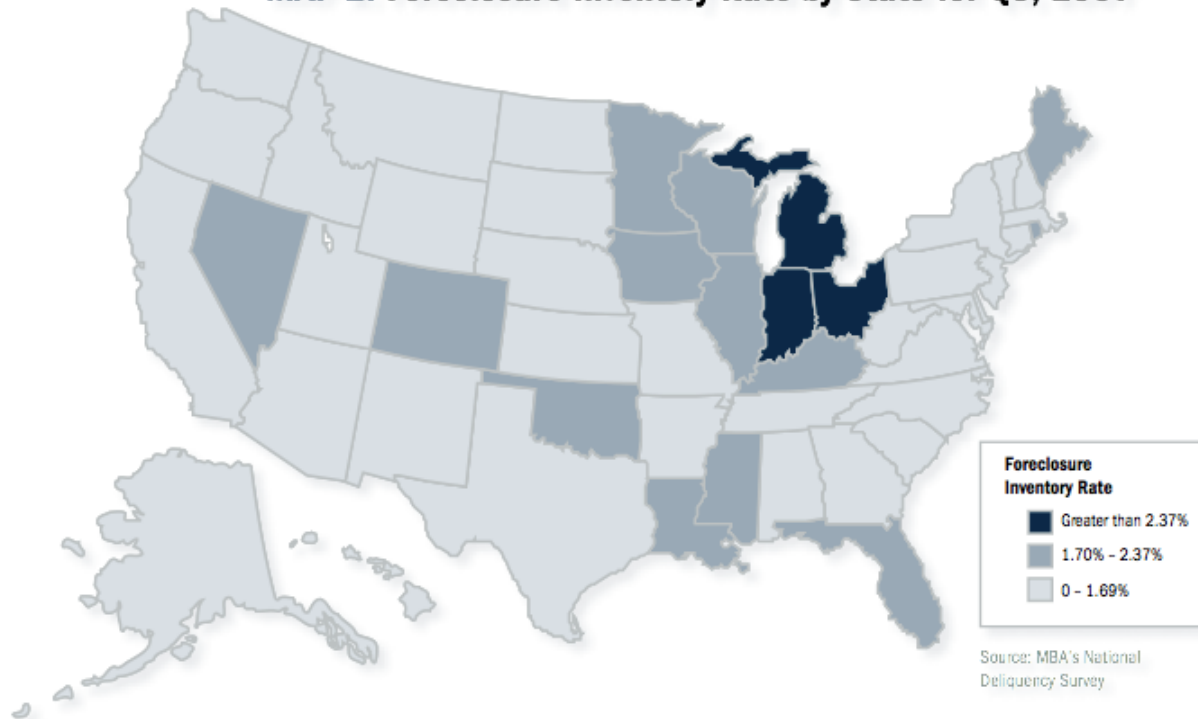


Source: Credit Suisse.



## Indiana is 2<sup>nd</sup> in Foreclosures (after Ohio)

**MAP 2: Foreclosure Inventory Rate by State for Q3, 2007**

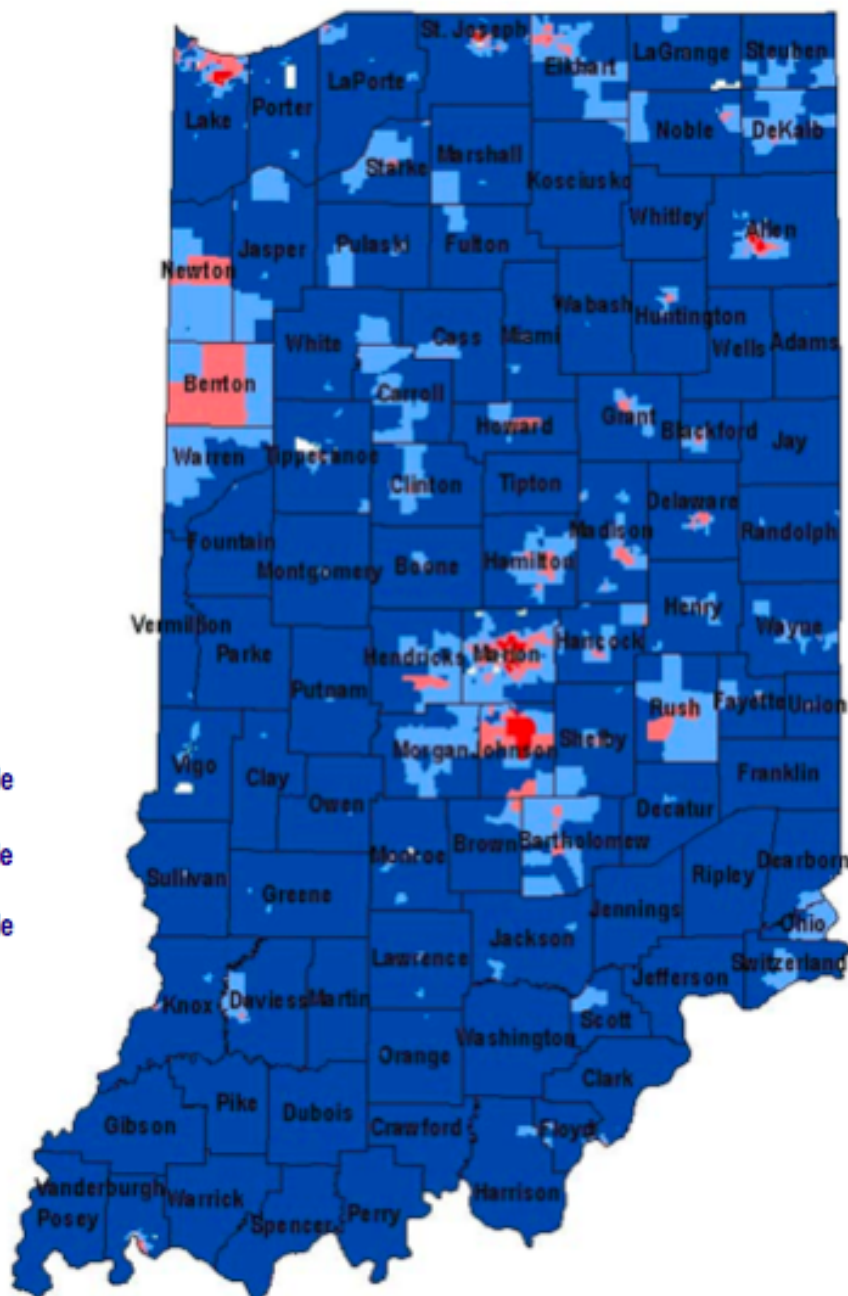
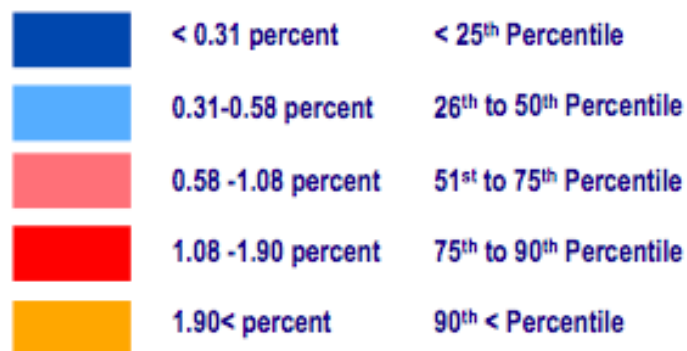


# Foreclosures not just an Indianapolis and Lake County problem



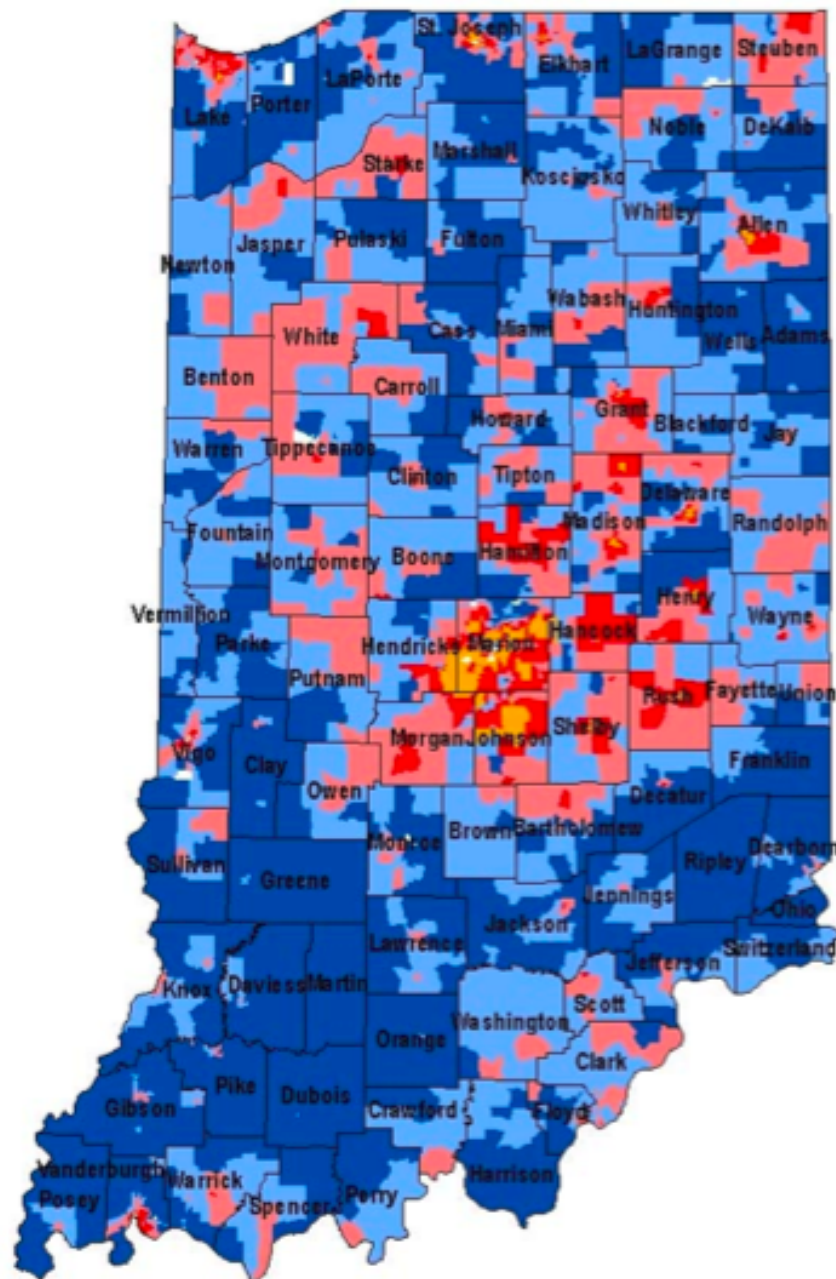
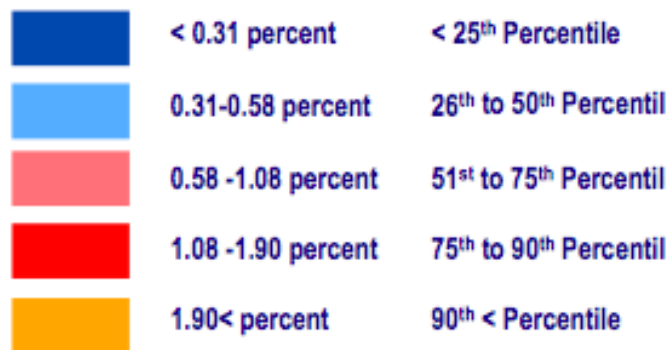
# 2002 Foreclosures

Spatial Smoothed Rate  
by Block Group



# 2005 Foreclosures

Spatial Smoothed Rate  
by Block Group



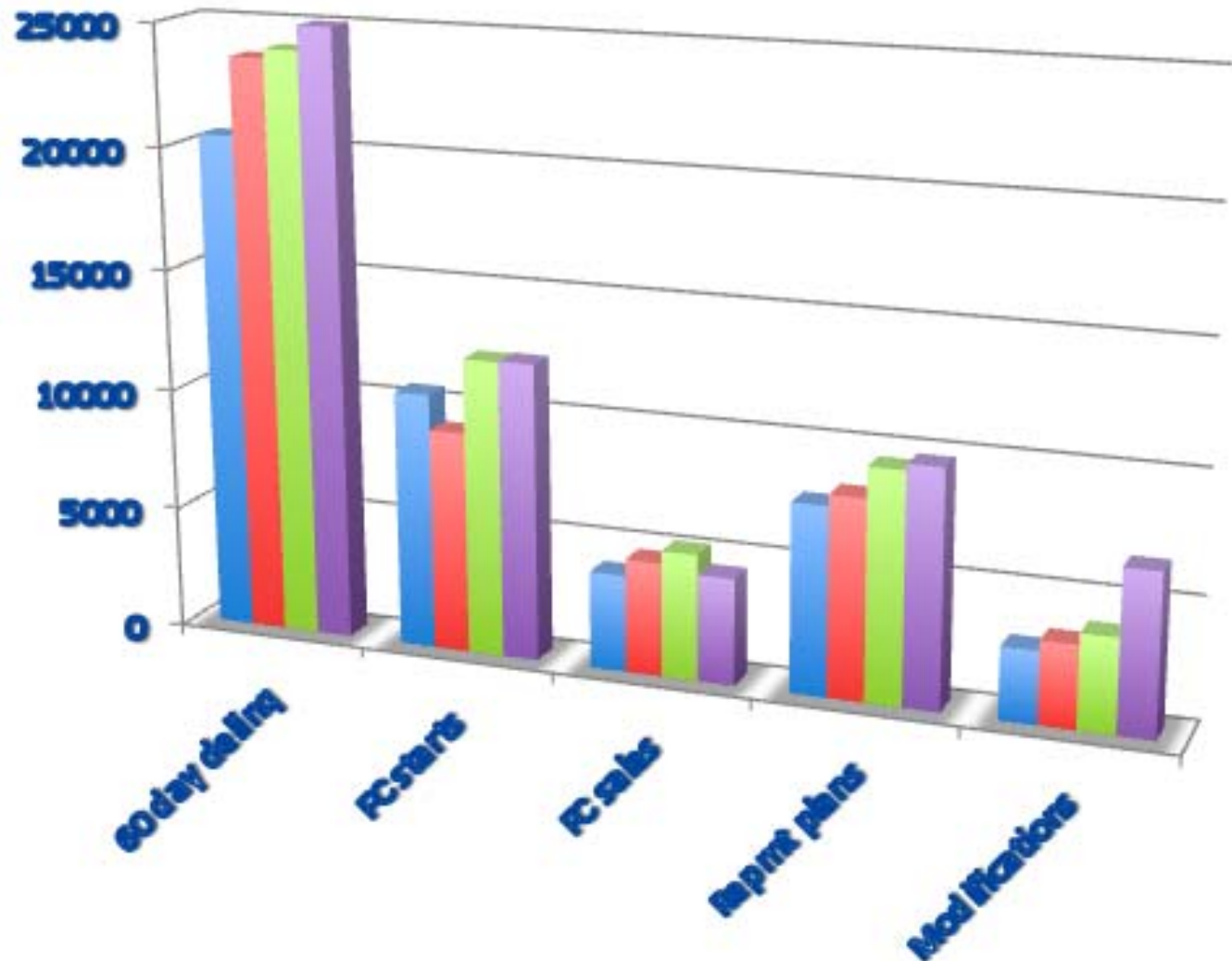
## Indiana Community Impact

- 14,000 subprime foreclosures will reduce values for
  - 578,000 nearby properties
  - \$581 million loss in values/tax base
- 
- Source: CRL, Subprime Spillover, 2007





## Indiana Foreclosures in the Pipeline by quarter, 2007





## Workouts are Possible

- 1.5 million foreclosure starts in 2007
- 500,000 foreclosure sales
- 335,000 loan modifications, mostly in the 4<sup>th</sup> quarter
- 1,183,000 repayment plans
- Source: HOPE NOW Loss Mitigation report Feb 2008



## Loan Modifications – Status Report

- Subprime servicers are modifying loans, far more aggressively in 2008 than 2007
- Repayment plans still predominate
- Short Refinance option may take off
- FHA Secure, HOLC proposals – more programs coming on line soon



## The Players

- Who holds the loan, who files foreclosure
- Who has authority to negotiate?
  - Servicer
  - “investor” who is that?
    - Fannie/Freddie
    - Portfolio lender, e.g. HSBC
    - Trustees and Pooling and Servicing Agreements
  - Repurchase by originator
- MERS
- Regulator - OCC, OTS, FDIC, State DFI; statement on servicing, p. 77

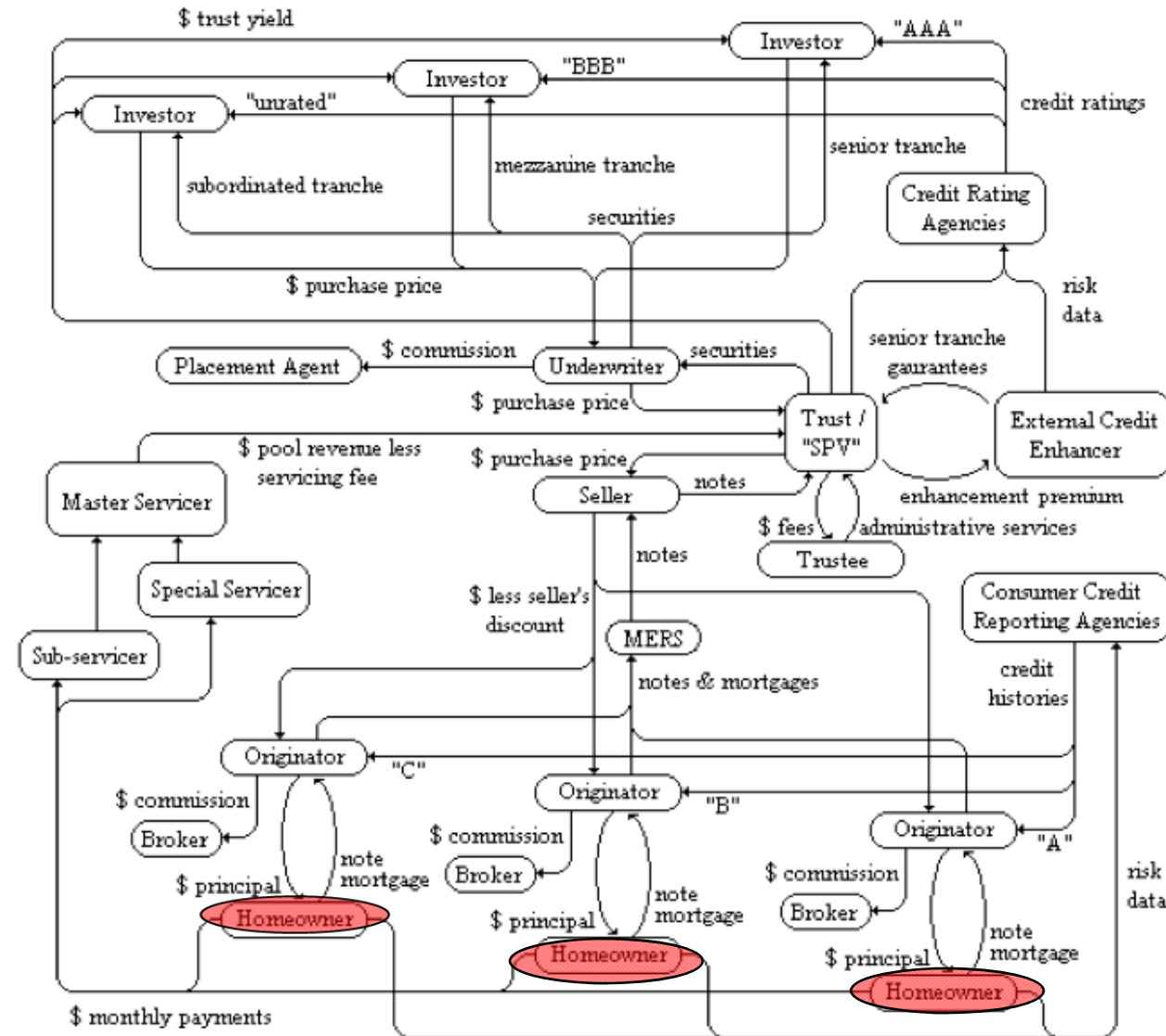


## The Players, cont.

- Bond rating agencies
  - Rate servicers and the bonds
  - Set standards for loan modification policies
  - Fitch and S&P description of loan modifications and loss mitigation in materials, explain what is allowed, encouraged



Figure A -- Subprime Home Mortgage Securitization Structure





## What authority does Servicer Have?

- Pooling and servicing agreement will spell it out
- Example – from Credit Suisse report: “servicer may waive or modify any term including rate, forgiveness of principal or interest, extending final maturity, or accepting short payoff”





## Loss Mitigation Order of Preference (from standpoint of servicers)

- Reinstatement
- Short term repayment plan
- Sale or Short Sale
- Deed in Lieu
- Trial modification
- Modification



## What Modifications are being Offered?

- Preferred tools of subprime servicers in 2007 include
  - Trial “modifications” 3 to 6 months, really forbearance: problem is transition to permanent modification
  - Deferral of rate reset for 1 or 2 years “kicking the can down the road”



## Preventable Foreclosures

- Property value declines
- Foreclosure recoveries about 50% to 60% of loan balances
- Fixing interest, or reducing rate, or reducing principal can make payment sustainable



# Why Preventable Foreclosures are Going Forward

- Shortage of counselors and servicer staff
- Foreclosures proceed while workouts being negotiated
- Servicers hands sometimes tied by PSA caps, fear of litigation
- Possibility of new refinance programs coming on-line



## Foreclosure Litigation – other States

- Ohio standing cases – real party in interest
- Baltimore fair lending case – City impacts
- Housing code enforcement vs. lenders – e.g. Buffalo, Minneapolis
- Temporary stays – Massachusetts v. Fremont



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# Consumer Litigation Options to Force Loan Modification



April 16, 2008

Christine M. Jackson  
Chris Jackson Law Office  
Indiana Chairperson for  
National Association of Consumer Advocates (NACA)

# Loan Flipping 101 – Equity Stripping of the Elderly and Unsophisticated

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	<u><b>Original</b></u>	<u><b>1<sup>st</sup> Flip</b></u>	<u><b>2<sup>nd</sup> Flip</b></u>
Loan	\$55,000	\$62,000	\$73,000
Closing	1/30/1998	4/04/2003	10/04/2004
%	7%	9%	5% - (10.9 to 14.9)
Term	30 fixed	30 fixed (PPP)	2/28 ARM (PPP)
Costs	\$1800	\$6,000	\$11,000
Cash Out	\$0	\$1,000 (med. loan)	\$2,700 (Escrow)
Mo. Pmt	\$366	\$499	\$391/\$674
Escrow	<u>\$150</u>	<u>\$ 0</u>	<u>\$150/\$150</u>
Total Pmt	\$516	\$499	\$541/\$824

# Going it Alone

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- ❑ Complexity of the players involved
- ❑ Complexity of the financial transaction
- ❑ Inability to get documentation needed
- ❑ Inability to read account history statement if received from loan servicer
- ❑ Difficulties getting the servicer to modify the loan to make it affordable

# Indiana Trial Rules

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- ❑ “Real Party in Interest” – TR § 17
- ❑ Contract to Support Claim – TR § 9(A)
- ❑ Standing to Sue
  - Does the Plaintiff have an actual demonstrable injury for purposes of a lawsuit.

*Schloss v. City of Indianapolis*

553 N.E.2d 1204 (Ind. 1990)



# Using Federal Statutes to Save Homes

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- ❑ Real Estate Settlement & Procedures Act (RESPA)
- ❑ Truth in Lending Act (TILA)
- ❑ Federal Debt Collection Practices Act (FDCPA)
- ❑ Equal Credit Opportunity Act (ECOA)
- ❑ Private Mortgage Insurance Technical Corrections and Clarification Act (PMITCCA)
- ❑ Bankruptcy code

# Real Estate Settlement & Procedures Act (RESPA) - 12 U.S.C. § 2601 et seq.

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- No Kick backs or Unearned Fees
  - Yield Spread Premiums (YSP)
- Duty to make timely escrow payments
  - Most predatory loans also are associated with sloppy loan servicing
- Duty to respond to QWR
  - Loan information requests to determine Note holder, fees charged and application of consumer payments
- Duty to provide Transfer of Servicing Statement
  - No penalty if payment sent to prior loan servicer the first 60 days of change.

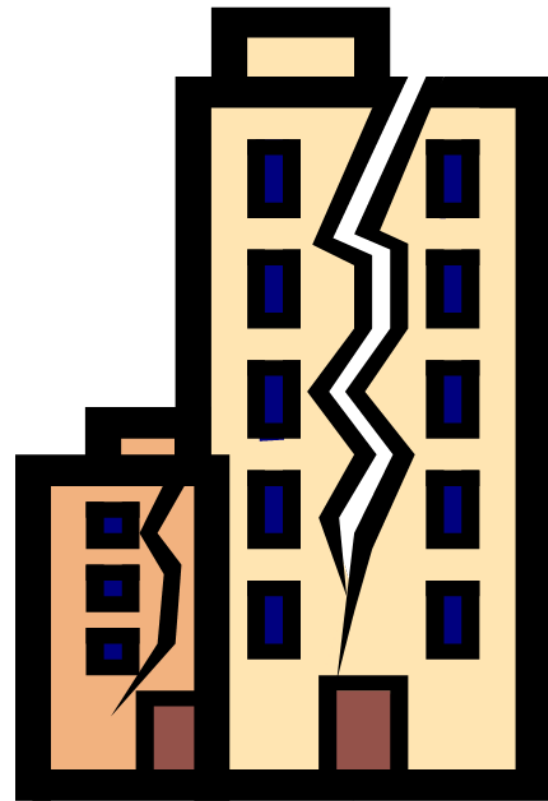




# Truth in Lending Act (TILA)

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- ❑ 15 U.S.C. § 1601 *et seq.*
- ❑ Disclosure Statute
- ❑ Powerful Remedies
  - Rescission
  - Statutory Damages
  - Actual Damages
  - Attorney Fees



# TILA Rescission for Refinanced Home Loans Less Than 3 Years Old

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- TILA rescission is an excellent remedy
  - Lender security interest is void
  - Borrower gets credited for all closing costs and interest paid
  - Can make an unaffordable loan affordable



# TILA Rescission Available When

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- ❑ Lender fails to provide accurate or correct number of copies of Notice of Right to Cancel loan
- ❑ “Material” disclosure is incorrect on TILA disclosure

form

- Annual Percentage Rate (APR)
- Finance Charge (FC)
- Amount Financed (AF)
- Total Payments (TP)
- Payment schedule



# Example of Rescission Tender Calculation

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March 9, 2005 loan amount	\$75,000.00
<i>Less</i>	
Closing costs	\$ 5,559.38
Payments made since closing	<u>\$17,800.61</u>
02/01/08 Net tender amount	\$51,640.01
<i>Less</i>	
TILA Statutory Damages	<u>\$ 4,000.00</u>
New principal loan balance:	<b>\$47,640.01</b>

# Notice of Rescission

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- Upon notice of rescission, lender must within 20 days
  - Desist from making claims for finance charges
  - Return all money paid in the transaction
  - Satisfy all security interests, including mortgages acquired in loan transaction

# Fair Debt Collection Practices Act (FDCPA) 15 U.S.C. § 1692 *et seq.*

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- ❑ Law Firms filing foreclosure actions requesting a deficiency judgment are debt collectors under the FDCPA



*Overton v. Foutty & Foutty*

2007 WL 2413026 (S.D. Ind., Aug 21, 2007)



# Debt Collectors under FDCPA

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- ❑ Have a duty to provide written notice within 5 days of initial communication & validate debt if requested.
- ❑ Communication restrictions
- ❑ No false or misleading representations, harassment, abuse, or unfair practices in the collection of debt



# Indiana State Statutes

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- ❑ Loan Brokers: IC § 23-2-5-1 *et. seq.*
- ❑ Consumer Credit: IC § 24-4.5-1-101 *et. seq.*
- ❑ Home Loan Practices Act: IC § 24-9-1-1 *et. seq.*
- ❑ Home Improvement Protection Act: IC § 24-5-44-1 *et. seq.*
- ❑ Civil Conversion, Deception, Mischief: IC § 34-24-30-1  
(because Indiana UDAP Statute exempts real property claims)

# Indiana Common Law

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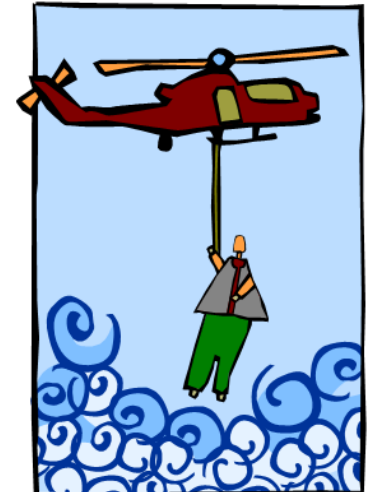
- ❑ Breach of Contract
- ❑ Promissory Estoppel
- ❑ Misrepresentation
- ❑ Fraud
- ❑ Unconscionability



# Foreclosure Rescue Schemes

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- ❑ During first month after foreclosure action filed, a Marion county consumer receives about 50 solicitations “for assistance”
- ❑ Various “Homesaver” schemes
  - Fake re-financing offers
  - Sale and leaseback schemes
  - Mortgage fraud analysis (\$1,500)
  - Unscrupulous (or misinformed) attorneys.



# Judicial intervention

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- Early settlement conference or mediation
- Timely production of documents
- Policing of “bad apple” lawyering
- Pressure on loan servicer to modify loan terms.



# Additional Resources

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## National Consumer Law Center

- ❑ NCLC for short
- ❑ Offers technical assistance, publications and training for lawyers & consumer advocates
- ❑ Publishes the NCLC Manuals – the “Bibles” of Consumer Law.

**[www.consumerlaw.org](http://www.consumerlaw.org)**

